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CONSUMER RIGHTS AND MULTILEVEL MARKETING (PYRAMID) SCHEMES

§ 22. 1. Introduction

This consumer rights chapter describes the possible civil and criminal penalties for entering into a pyramid scheme. It contains the following sections:

§ 22. 2. Pyramid Schemes Are Illegal

§ 22. 3. The Maine Statute Prohibiting Pyramid Schemes

§ 22. 4 Why “Gifting” Pyramids Are Illegal

§ 22. 2. Pyramid Schemes Are Illegal

The Maine Legislature at 17 M.R.S.A. § 2305 has enacted a very strict civil and criminal statute prohibiting many forms of multi-level marketing businesses such as pyramid clubs. If a multi-level marketing scheme is in violation of this statute, it is illegal for that company to do business in the State of Maine. Violation of this statute can be a civil Unfair Trade Practice and a *Class E crime*.

Pyramid schemes are inherently deceptive and contrary to public policy. The deception arises because the market can quickly become saturated and the seemingly endless chain can rapidly end. Consequently, many participants will never even recoup their investments, let alone make a profit. (*See In re Holiday Magic, Inc.*, 84 F.T.C. 748) (Oct. 15, 1974). For example, the chart below shows what happens when the first seller sells six memberships and, in turn, each of the six buyers sells six more, and the cycle is repeated:

Participants

1

6

36

216

1,296

7,776

46,656

279,936

1,679,616

10,077,696

60,466,176

362,797,056

(Exceeds U. S. Population)

2,176,782,336

13,060,694,016

(Exceeds World Population)

Even if the pyramid scheme involves the sale of a specific consumer product (*e.g.*, motivational tapes), if this product is sold to persons who are also purchasing the right to membership in the pyramid, then Maine law can still be violated.¹ In general, be very leery of any multi-level marketing scheme in which you must purchase the product being sold in order to become a seller in the organization.

Pyramid schemes, in general, have been held to be inherently fraudulent because they must eventually collapse. *Webster v. Omnirition Intern., Inc.*, 79 F. 3d 676, 781 (9th. Cir. 1996); *SEC v. International Loan Network, Inc.*, 968 F. 2d 1304, 1309 (D.C. Cir. 1992); *Illinois ex rel. Fahner v. V. Walsh*, 461 N.E. 2d 78 (Ill. 1984) (holding pyramid scheme violated Illinois Unfair Trade Practice Consumer Law, which is identical to Maine's Unfair Trade Practice Act, 5 M.R.S.A. § 207).

Violation of this pyramid statute is also an unfair trade practice under 5 M.R.S.A. §§ 207.² If you have been injured by a multi-level marketing scheme, you may be able to go to court and receive your money back and your attorney fees (5 M.R.S.A. § 213). See Chapter 3, The Maine Unfair Trade Practices Act.

¹ See *People Ex Rel. Hartigan v. Dynasty System*, 471 N.E.2d 236, 241 (Ill. 1984) (pyramid scheme is illegal when benefits to participants are primarily based on adding new members and not on volume of goods sold).

² See *State of Maine v. Bigsmart.Com*, No. CV-00-82 (Me. Sup. Ct., Kenn. Cty. 2001) (Consent Decree in which Court imposed a \$40,000 civil penalty on multi-level "internet mall" and required it to be registered as a Transient Seller); *State of Maine v. Club Atlanta Travel, Inc.*, No. CV-97-101 (Me. Sup. Ct. Kenn. Cty., 1997) (Consent Decree in which court imposed on a multi-level marketing organization a civil penalty of \$5,000 and required it to be registered as Transient Seller).

§ 22. 3. The Maine Statute Prohibiting Pyramid Schemes

The Maine civil and criminal statute which prohibits pyramids reads as follows:

17 M.R.S.A. § 2305.

Multi-level distributorships, pyramid clubs, etc., declared a lottery; prohibited; penalties

The organization of any multi-level distributorship arrangement, pyramid club or other group, organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or given to any other member thereof who has been required to pay or give anything of material value for the right to receive such sums, with the exception of payments based exclusively on sales of goods or services to persons who are not participants in the plan and who are not purchasing in order to participate in the plan, which plan or device includes any provision for the increase in such membership through a chain process of new members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members, is declared to be a lottery, and whoever shall organize or participate in any such lottery by organizing or inducing membership in any such group or organization shall be guilty of a misdemeanor, and upon conviction thereof shall be punished by a fine of not more than \$5,000 or by imprisonment for not more than 11 months, or by both.

A violation of this section shall constitute a violation of Title 5, Chapter 10, Unfair Trade Practices Act.

§ 22. 4. Why “Gifting” Pyramids Are Illegal

This office has received many calls from people who have participated in one of the “gifting” pyramids that in the last few years have swept over the state of Maine. These pyramids have taken such names as **Changing Lives**, **NASCAR**, **A Woman’s Project** and other names. These “gifting” schemes are illegal pyramids and the Attorney General has gone to court to stop them³. Only the persons who reach the top of these quickly multiplying pyramids will receive money. All others will lose their money because the pool of possible recruits will quickly run dry. Further, organizers of these schemes often use deceptive sales pitches to entice new recruits (for example, “It’s perfectly legal;” or “It’s a gift so you do not owe taxes;” or “If you ever want to drop out, we guarantee that you will get back your money”).

A recent Superior Court’s decision in *State v. Chad Beauchere, et al., d/b/a Changing Lives*, No. CV-01-03 (Me. Super. Ct., Kenn. Cty., Feb. 4, 2003) describes why these “gifting” pyramids quickly exhaust potential new recruits (e.g., by the 20th level 4,194,304 *new* recruits are needed to keep the pyramid growing) and how much money is quickly lost (e.g., when it costs \$2,000 to join, if the pyramid collapses by the 21st level then \$14,680,064,000.00 is lost). Of course, such pyramids never come close to the 21st level. They fail much more quickly. Here is the Court’s conclusion:

³ See e.g., *State of Maine v. Theodore McLeod, Jr.*, No. CV-01-174 (Me. Super. Ct., Kenn. Cty., January 3, 2003) (the NASCAR “car club” declared an unfair trade practice and an illegal pyramid; restitution and civil penalties ordered); *State of Maine v. Joan Manfredi, d/b/a A Woman’s Project*, No. CV-02-88 (Me. Super. Ct., Kenn. Cty., February 28, 2004).

The Changing Lives pyramid scheme is an extremely damaging illusion because the need for new recruits will quickly exhaust the pool of available investors, with the result that many persons will lose their \$2,000 payments. This Court finds that Changing Lives participants who (1) reach the Senior position and (2) obtain money from new recruits have participated in a fundraising pyramid that is inherently unfair and deceptive and are in violation of both the Maine Unfair Trade Practices Act, 5 M.R.S.A § 207, and the civil portion of the State's Anti-Pyramid Statute, 17 M.R.S.A. § 2305, which makes participation in such pyramids a *per se* civil violation of the UTPA.

In addition to finding the Changing Lives pyramids in violation of the Maine Unfair Trade Practices Act, the court also ordered restitution and civil penalties.